Investment Services Sector: Risk Assessments

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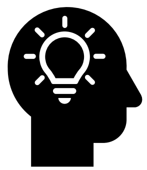
The RBA, BRA & CRA

For the risk-based approach (RBA) to be effectively applied, the subject person must identify and assesses its exposure to ML/FT risks, as well as understand what the various risks are and how they may manifest themselves.

This is done by:

- Understanding and assessing the risk that **one's** business is in general exposed to: Business Risk Assessment (BRA).



- Understanding and assessing the risk to which a subject person will be exposing themselves to when establishing individual business relationships or carrying out a given occasional transaction: Customer Risk Assessment (CRA).

Risk Factors

Those variables that either on their own or in combination with each other may increase or decrease the ML/FT risk posed to a subject person.

Regulation 5(1) of the PMLFTR

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Subject persons are to identify and assess the ML/TF risk associated with:

- the products and services they offer
- the jurisdictions they operate in
- the customers they attract
- the delivery channels they use to service their customers

Customer Risk

Customer's Behaviour:

- The rationale for the investment lacks an obvious economic purpose or the customer makes investments that are inconsistent with the customer's overall financial situation.
- The customer asks to repurchase or redeem a long-term investment within a short period after the initial investment, or before the payout date without a clear rationale.
- The customer requests the repeated purchase and sale of shares within a short period of time without an obvious strategy or economic rationale.

Customer Risk (2)

Customer's Behaviour:

- Unwillingness to provide CDD information on the customer and the beneficial owner.
- The customer transfers funds in excess of those required for the investment and asks for surplus amounts to be reimbursed.
- Multiple accounts are used without previous notification, especially when these accounts are held in multiple jurisdictions or jurisdictions associated with higher ML/TF risk.
- Sudden change of settlement location without rationale.

Customer Risk (3)

Customer's Nature

-When a subject person is to establish a business relationship with a collective investment scheme or is to otherwise carry out an occasional transaction for the same, the subject person should assess the regulatory status of the said scheme.

-The subject person would need to consider the kind of business carried out by the collective investment scheme since the actual ML/TF risks posed by its business will vary depending on:

- the type of underlying investors it is marketed to
- the markets the collective investment scheme is marketing its units in
- what is its investment strategy
- what kind of subscriptions it accepts

Geographical Risk

-Geographical risk is likely to manifest itself in terms of where:

- its customers are resident or otherwise established
- the activities generating the funds that are to be invested are located
- funds are received/sent

-Service Providers needs to take the following into account:

- the jurisdiction where the collective investment scheme is established and, where applicable, subject to regulatory oversight
- where it is being marketed
- where it is investing its funds

Product, Service and Transaction Risk

- Products or services that may inherently favour anonymity or obscure information about underlying customer transactions.
- A request is made to transfer funds to a higher risk jurisdiction without a reasonable business purpose.
- The absence of any capping to the amount that can be invested through a single subscription.
- The absence of any lock-in period for one's subscription.
- The ability to subscribe to units in the collective investment scheme in kind.
- Allowing subscriptions to be financed by third parties and/or allowing the proceeds of any redemption to be transferred to third parties.

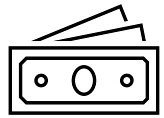
Delivery Channel Risk

- A collective investment scheme does not always deal with its customers directly. Usually, a collective investment scheme will have a distribution network in place through which its units are marketed and subscribed to. The risk increases as the network becomes more extensive and its layers increase.
- These distributors may be the ones carrying out the initial CDD measures mandated by the collective investment scheme. Thus, there will be a dependence on the quality of the implementation of these measures by its distributors and sub-distributors.
- To the extent that the distributor is itself a regulated entity subject to equivalent AML/CFT obligations as the collective investment scheme, the ML/TF risk from a delivery channel point of view will be less than in situations where the distributor does not meet either or both of the said criteria.

The SNRA

- When drawing up the BRA, the PMLFTR obliges subject persons to consider any supranational risk assessment (SNRA), as well as any national risk assessment. The BRA should provide a clear explanation of how the assessments were used as sources of information when identifying and assessing risk factors.

- The features and nature of investment funds make them vulnerable to the laundering of proceeds derived from fraud, tax crimes, corruption, and bribery. The risk is further driven by the sector's exposure to high-risk clients, as well as the high volume, complexity and cross-border nature of transactions.



- There are various scenarios where criminals can commit abuses against investors or financial markets resulting in, or amounting to, money laundering. For instance, criminal proceeds may be used to purchase investment products.

The SNRA: Threat & Vulnerability of TF

- The terrorist financing threat related to retail and institutional investment could be significant if large amounts of legitimate funds are invested to finance terrorism, but when it comes to generating small amounts to commit terrorist attacks, the terrorist financing threat is not significant in this product/sector.

- Terrorist financing vulnerability related to investment services presents a less significant inherent risk. Risk factors do not favour the use of these products and services for terrorist financing purposes. Perpetrators usually do not have the expertise to access the sector, while the low amounts of money used to finance terrorist attacks made other sectors more attractive for their purposes.

- Assessment of the terrorist financing vulnerability related to investment services is considered as less significant (level 1).

The SNRA: Threat & Vulnerability of ML

- When investment services involve intermediation by brokers, ML vulnerability is higher than when those services are directly to end customers.

- Lack of resources to apply robust CDD procedures and conflict of interest over attracting customers with a high-risk money laundering profile such as politically exposed persons, customers from high-risk non-EU countries and high-income customers can increase vulnerability.

Risk level

As regards **terrorist financing**, the level of threat has been assessed as non-relevant (1>).

RISK	
1 – 1,5	Lowly significant LOW
1,6 – 2,5	Moderately significant MEDIUM
2,6 – 3,5	Significant HIGH
3,6 – 4	Very significant VERY HIGH

As regards **money laundering**, the level of threat has been assessed as significant (3), while the level of vulnerability has been assessed as moderately significant/ significant (level 2/3).

	RISK	
	1 – 1,5	Lowly significant LOW
	1,6 – 2,5	Moderately significant MEDIUM
➔	2,6 – 3,5	Significant HIGH
	3,6 – 4	Very significant VERY HIGH

Conclusions: estimated risk level for money laundering is HIGH.

BRA: Administrative measures imposed on CIS & Investment Services Providers

- The risk factors identified within the BRA are not specific to the business activities of the subject person and were generic in nature

  Since this subject person is a fund administrator, the BRA was expected to include risk factors relating to:

  - the types of funds it services;
  - the target market of the funds;
  - the types of assets that would be included in the fund;
  - the types of customer that the fund will attract;
  - how the company monitors the investments and transactions taking place.

- The methodology adopted was not adequate

  Subject persons need to assess the risks that they are exposed to because of the business relationships they engage in. This needs to be done by assessing the inherent risk which depends on the identification of the existent threats and vulnerabilities as specified by Regulation 5(1) of the PMLFTR.

BRA: Administrative measures imposed on CIS & Investment Services Providers (2)

- The **Company's** BRA provided no rationale as to how the inherent risk rating for each risk factor and ultimately the overall results were achieved

Determining both the weaknesses that may be exploited for ML/FT purposes as well as the external elements that seek to exploit a subject person's vulnerabilities is important. It's necessary to document this knowledge.

- Geographical Risk Exposure: the assessment was merely a list of external information sources

The geographical risk assessment is not merely about having a rating but rather it is about understanding where the risk derives from to be able to mitigate it. The BRA should have detailed the jurisdictions with which the company had established connections, and the risks these exposed it to, as well as the measures to be applied to mitigate the risks identified.

BRA: Administrative measures imposed on CIS & Investment Services Providers (3)

- A generic BRA prepared by the fund administrator or by a consultant which do not feature the specific risks pertaining to the fund

The BRA should be tailored to the investment service provider's business profile and should take into account the factors and risks specific to the firm's business, whether the firm draws up its own BRA or contracts an external party to draw it up.

- The BRA failed to outline potential ML/FT risks emanating from a significant risk that the company was exposed to, i.e., outsourcing

In compiling their BRA, subject persons have to also consider whether there are additional risk factors that would need to be considered. The company had to consider whether the entity it was outsourcing to had sufficient processes, controls and measures in place to meet legal requirements, and whether there were potential ML/FT risks through such agreement.

BRA: Administrative measures imposed on CIS & Investment Services Providers (4)

- Company was required to revise and update its BRA whenever there were changes to its business model/structures/ activities

In this case, although the company acquired over 6,000 customers, the BRA made no reference to the significant expansion of its client base.

The company had to revise and update its BRA whenever circumstances change or relevant new threats emerge.

Subject persons are reminded that even if business operations have not undergone major changes, it is important that they set out an annual review process to determine whether their BRA is valid and current.

CRA: Administrative measures imposed on CIS & Investment Services Providers

- The CRA methodology did not consider all the risk pillars which rendered the subject **person's** CRA inadequate and insufficient

- In the absence of an adequate CRA, the subject person may end up attributing risk ratings that do not truly reflect the customers' risks. It is especially important that the subject person adopts and applies a CAP. This policy is to provide a description, with non-exhaustive examples, of
- the type of customers that are likely to pose a higher than average risk of ML/FT;
- the risk indicators that will lead to a business relationship or an occasional transaction being considered as presenting a low, medium or high risk of ML/FT;
- the level of CDD measures, including ongoing monitoring to be applied in their relation;
- under what circumstances the subject person will decline to service someone.

CRA: Administrative measures imposed on CIS & Investment Services Providers (2)

- There was no rationale detailing the consideration of such CRA and no rationale behind the final risk scores assigned

  Rationale is to be clearly outlined by a subject person's CRA and in turn it is to be ensured that appropriate mitigating measures/controls are applied to minimize the specific increased ML/FT risk identified. Documenting this process is important both to confirm when the assessment was done, as well as the considerations taken to arrive at the final risk score.

- CRA failed to consider the ML/FT exposure of its **customer's** jurisdiction and from where the funds generating the investments originated

  Certain risks prevalent in each country such as transparency issues, corruption and bribery alongside other prevalent crimes should be evaluated. Such considerations are indispensable to have a sound understanding of the risks presented by a jurisdiction to which a customer is exposed, and to determine the level of controls necessary.

CRA: Administrative measures imposed on CIS & Investment Services Providers (3)

- Adverse media screening was not performed or it was performed late

  When conducting a customer risk assessment, it is essential to consider the reputation, nature and behaviour of the customer. Subject persons are also required to take into account the behaviour of a customer, including whether they are cooperative in providing information or whether the documentation provided is authentic or otherwise.

- No considerations were made in relation to the product/service risk

  The details of the product offered by the company such as the different investment opportunities vary and need to be factored in as a risk consideration. Although the company had a risk assessment procedure in place, the risk rating process implemented was not widely effective to depict a correct risk image of the customer and to ensure the necessary controls are taken.

Thank you!

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